Economic Spotlight

July 6, 2012

Alberta's Housing Market: On the Upswing

Alberta's housing market is bouncing back from a relatively soft year in 2011. This note looks at recent trends in the housing market and the outlook for the remainder of this year.

Home construction trending upwards

New home construction is on the rise again in Alberta. After a slow start to 2011, housing starts have risen in each of the last four quarters. In the first five months of 2012, housing starts averaged over 32,300 (seasonally adjusted at annual rate, SAAR), a 47% (ytd) increase over the same period last year.

Some of the improvement this year reflects a return to more normal levels after an unusually weak first half in 2011. According to Canada Mortgage and Housing Corporation (CMHC), housing starts were exceptionally weak in late 2010 and early 2011, held back by a long cold winter and higher inventory.

One of the key drivers of the increase in housing construction activity has been Alberta's strong labour market, which has raised incomes and attracted new migrants. As shown in Chart 1, the recent rebound in housing starts coincides with rising inter-provincial migration into Alberta.

Single and multiple starts contribute to recent gains

With high unabsorbed inventory, construction of single detached homes weighed on 2011's housing starts, which decreased 14.9% to 15,193. However, single detached home starts are now regaining traction. In the first five months of 2012, single starts are up a strong 10% over last year. The largest gains, however, continue to come from multiple unit construction (e.g. condominiums). Building on a 13.8% increase in 2011, multiple starts this year up to May have more than doubled (115%, ytd) over the same period last year.

Highlights

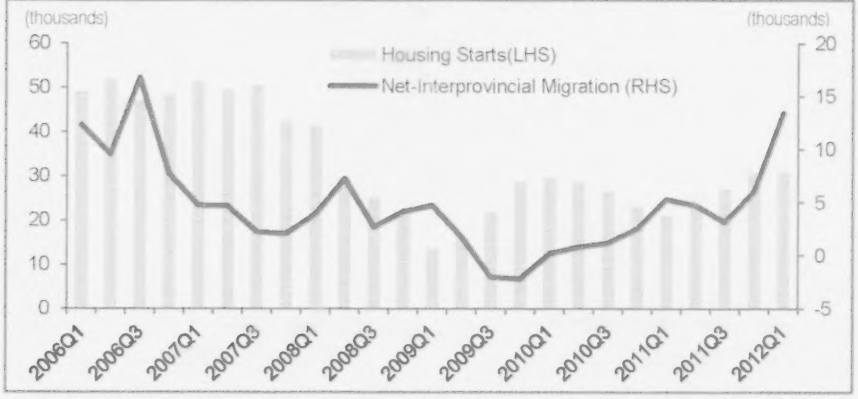
After a slow start in early 2011, new housing construction has picked up markedly. A number of factors, including low interest rates, seasonal construction effects, strong employment, and migration growth have contributed to the improvement.

Despite more resale activity and fewer listings, housing prices have remained relatively stable.

Housing affordability improved in 2011 due to stable prices and strong income growth. Alberta buyers have benefited from flat prices, rising income and employment.

Housing starts and resale activity are set to improve in 2012, lifted by low interest rates, stronger net migration and a tighter rental market.

Chart 1: Alberta Housing Starts* and Net Interprovincial Migration



* Seasonally adjusted at annual rate

Sources: Statistics Canada, Canada Mortgage and Housing Corporation

Existing home sales continue to trend higher

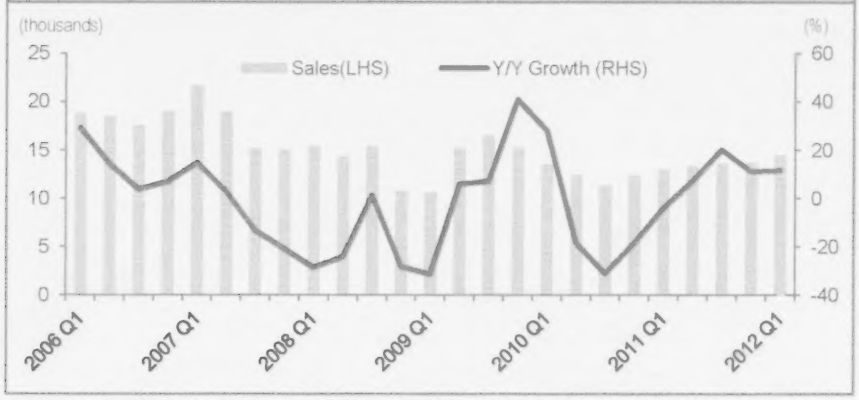
After hitting the lowest level in eight years in 2010, sales of existing homes have been trending upwards. In 2011, 53,755 existing homes were sold, a solid 8.1% annual improvement. The positive momentum continued into the first five months of 2012, with the number of sales climbing 17.4% (ytd).

Alberta moves closer to a sellers market

Overall, despite the uptick in construction, buyers have had fewer listings to choose from in Alberta. Total new listings were 105,747 units in 2011, down 4.0% from 2010. So far in the first five months of 2012, the number of new listings have fallen slightly by 0.5% (ytd).

As a result of more sales and fewer listings, the Alberta housing market is moving closer to sellers' territory. The sales-to-new listing ratio has risen to 57.7% as of May, inching closer to the 60% threshold required to reach what is considered sellers' market territory. A sales-to-new listing ratio below 40% is considered a buyers market, while a ratio in between 40% and 60% is balanced.

Chart 2: Alberta Sales of Existing Homes



Source: Canada Real Estate Association

Chart 3: Sales-to-New Listings Ratio

Source: Canada Real Estate Association

Stronger economic conditions support improvements in housing

Alberta's housing market is benefiting from a thriving economy, and the related increase in housing demand. More specifically, the following factors have likely played a role:

- Alberta's labour market led the country in job creation last year with annual employment growth of 3.8% in 2011. The strong labour market has continued through the first six months of 2012, posting growth of 3.4% (ytd). Most of the jobs created have been full-time positions.
- Healthy wage gains have made housing more affordable. Average weekly earnings rose by a nation-leading pace of 4.6% last year, although earnings have since moderated below 3% (ytd) through the first four months of 2012.
- Inter-provincial migration, a major source of household formation growth, has picked up, reflecting the province's robust labour market. In 2011, Alberta welcomed 19,141 interprovincial migrants compared to gaining only 4,616 in 2010 and 2,194 in 2009. In the first quarter of 2012 alone, Alberta gained 13,396 migrants from other provinces, marking the strongest quarterly increase since 2006. Alberta has witnessed net inflows from other provinces in each of the last nine quarters.
- A tighter rental market is likely encouraging renters to consider home ownership. CMHC's rental market statistics shows that Alberta's rental vacancy rate declined in 2011, especially in Calgary, while average rent rose across all apartment unit types. The latest CMHC's rental market report shows that the average apartment vacancy rate in Alberta was 3.0% in April, down from 4.7% in April 2011.
- Continued low mortgage rates reduce the cost of home ownership. Interest rates have stayed near historic lows as the Bank of Canada has held its policy rate at 1% since September 2010. In response to a lower cost of borrowing, banks and other

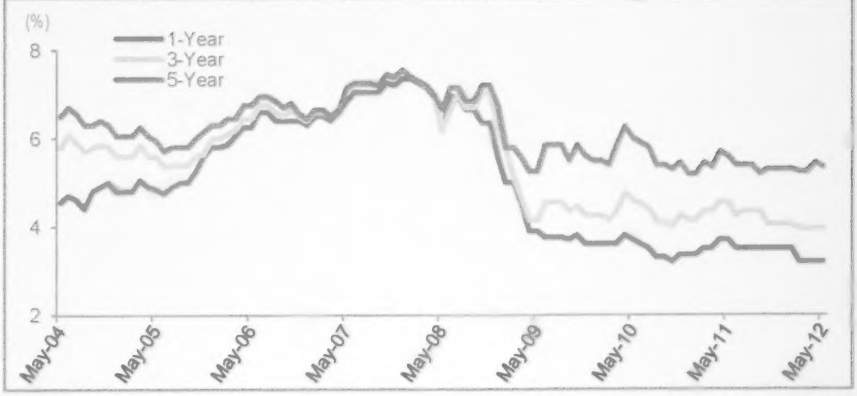
lending institutions have lowered mortgage rates, providing a major boost to activity in the housing market.

House prices remain stable

Despite the uptick in the market, housing prices have remained relatively flat in Alberta since hitting their 2009 cyclical lows. In 2011, the average resale price was $353,390, a mere 0.3% above 2010 level, while new house prices edged up only 0.4% (see chart 5). In comparison, the average resale Canadian home price grew 7.1% to $363,116 in 2011, led by increases in British Columbia (11.1%), Ontario (6.9%), and Newfoundland and Labrador (6.9%). Stable prices have so far carried into this year. In the first five months of 2012, Alberta resale market prices were up only 1.3% (ytd), slightly above the 0.5% (ytd) national average.

An overhang of inventory from the 2004-2007 housing boom has helped keep price increases contained. Over this period, housing prices doubled and supply ramped up, with starts reaching a record high of 49,000 in 2006. This large supply of new homes appears to have helped absorb any additional demand since the recession ended without putting much upward pressure on prices. In addition, construction costs have been relatively contained. The cost of building an apartment, for example, declined in 2009 and 2010, and increased modestly in 2011. While cost pressures have been picking up, they are not close to that observed in 2006 and 2007. Growth in the apartment construction price index in Edmonton and Calgary hit 4.7% (y/y)in the first quarter of 2012, its highest reading since late 2008, but still below the +10% (y/y) pace in each quarter of 2006 and 2007.

Chart 4: Mortgage Rates (%)



Source: Bank of Canada

Regional Housing Conditions

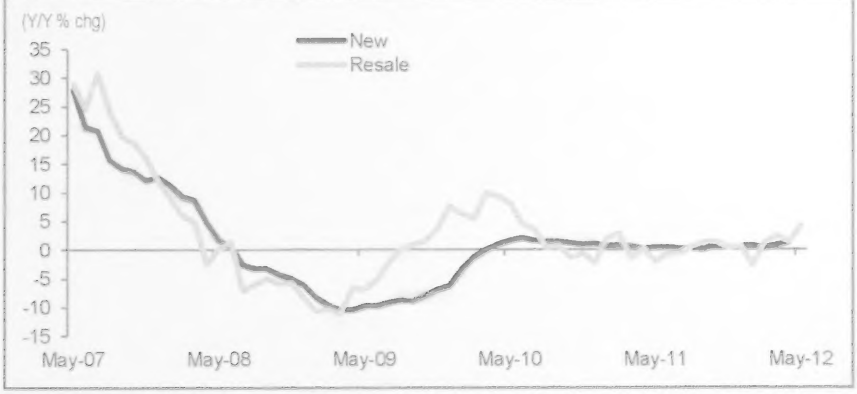
Housing starts rise across nearly all regions in early 2012

Alberta's overall improvement in housing starts reflects fairly broad-based regional gains with a few exceptions. In the first five months of the year, Calgary led all areas with starts doubling over last year, reflecting gains in both single and multiple units.

However, not all areas have seen starts rise. Grande Prairie and Fort McMurray starts were down in the first five months of the year over last year. Lethbridge also saw a further decline following a pullback in 2011.

The major cities, who attract most new migrants, continue to account for the bulk of activity, with starts in Calgary and Edmonton making up more than 85% of total starts in Alberta. Construction of new homes is up signficantly in both of these cities in the first five months of the year compared to last year.

Chart 5: Alberta House Prices (year-over-year Percentage Change)



Sources: Canada Real Estate Association and Statistics Canada

Market conditions tighten in almost all regions

For sellers, market conditions are improving across Alberta, reflecting a combination of stronger sales and fewer listings. While Fort McMurray is the only area to see the sales to new listing ratio moderate in the first five months of 2012, its housing market is still the most tilted towards sellers' territory.

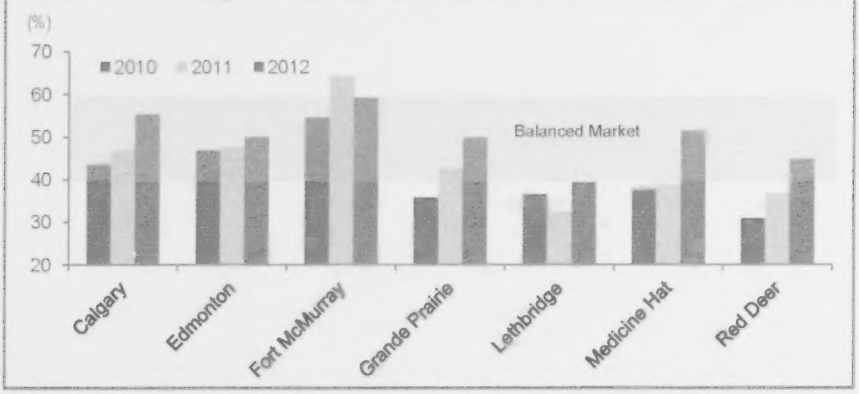
In Red Deer, market conditions moved into balanced territory over the first five months of 2012, after spending the last two years firmly in the buyer's zone. Calgary's resale market has

Table 1: Housing Starts by Region, January - May 2012

	Single – Detached		Multiple – Family		Total	
	Level	% Change*	Level	% Change*	Level	% Change*
Calgary CMA	2,299	21	3,561	291	5,860	108
Edmonton CMA	2,073	16	2,345	51	4,418	33
Wood Buffalo CA	99	-32	86	-95	185	-3
Grande Prairie CA	120	-25	34	143	154	11
Lethbridge CA	193	10	12	-94	205	-43
Medicine Hat CA	65	33	24	140	89	51
Red Deer CA	122	-7	134	139	256	42
Other Places	477	31	362	38	115	33
TOTAL	5,333	15	6,311	115	11,644	49

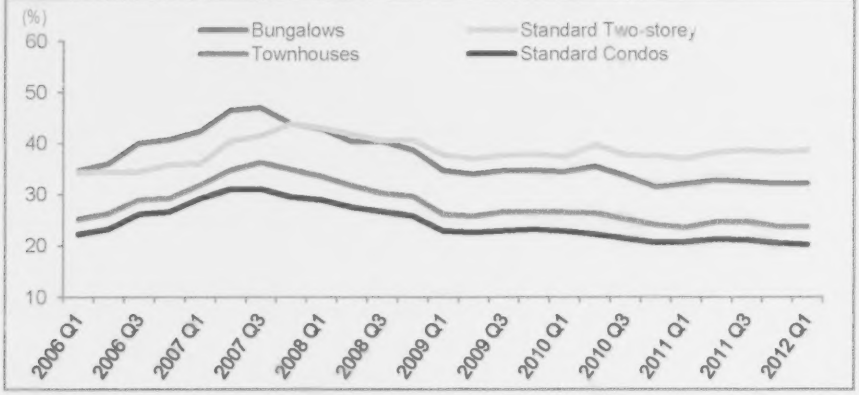
Source: Canada Mortgage and Housing Corporation; Actual January to May 2012 vs same period in 2011

Chart 6: Sales-to-New Listings Ratio by Region (January - May)



Source: Canada Real Estate Association

Chart 7: Alberta Housing Affordability Index*



* Share of pre-tax household income devoted to homeownership costs

Source: Royal Bank of Canada

also seen a notable improvement, with the city nearly hitting seller's territory over the first five months of the year.

Lethbridge was the only region in buyer's market territory, despite an improvement in its sales-to-new listing ratio.

Fort McMurray and Red Deer see largest price gains so far this year

In the first five months of 2012, Fort McMurray's average house price has increased by 10.0% (ytd), more than any other area. Red Deer has also seen a fairly large increase, with the average house price climbing 7.1% over the same period. All other regions continue to be fairly stable, with prices growing by less than 5% (ytd) so far this year.

Housing Affordability

Alberta's affordability improves

With stable house prices, solid income growth and lower mortgage rates, housing affordability in Alberta has been improving since 2007 (see chart 7). RBC's Housing Affordability Index calculates the proportion of pre-tax household incomes needed to service home ownerships costs such as mortgage payments, property taxes, and utilities. After peaking in the third quarter of 2007, Alberta's affordability index has steadily fallen, with the 2011 reading hitting a 6-year low.

Across Canada, a key factor supporting housing affordability is low interest rates, which has helped offset the effect of ongoing price increases. The prime rate has been unchanged since September 2010, the last time the Bank of Canada changed the policy rate, and fixed mortgage rates are currently near historic lows. Low interest rates continue to keep Canada's affordability index below its 25-year average for all segments.

Alberta has the most affordable housing in Canada for all housing types, according to RBC. Although Alberta has the third highest average housing price among the provinces, this is more than offset by average weekly earnings that rank highest in Canada. British Columbia

continues to have the least affordable housing in Canada, reflecting the highest average house price and earnings below the Canadian average. Vancouver and Toronto are cited by many analysts as the two most vulnerable cities for a market correction due to recent price increases and the resulting deterioration in housing affordability. Indeed, prices have already started to soften in Vancouver.

2012 Outlook

Alberta housing market on track for a solid year

Alberta's housing market is clearly on pace to rebound in 2012. Housing starts are already having a better year, rising nearly 50% in the first five months over last year. Stronger spending is set to continue, with residential building permits, an indicator of future construction activity, rising in the first four months by 22% (ytd).

Economic fundamentals are mainly supporting this year's expected gain in the housing market. Migration to Alberta, a major source of household formation, has picked up on the back of strong job gains. In the rental market, conditions are tightening, with April rental vacancy rates dropping in Calgary and Edmonton compared to a year ago. Moreover, the combination of stable housing prices, low interest rates and rising incomes continues to contribute to improvements in housing affordability and demand.

A recent tightening of mortgage rules is one factor that could weigh on the housing market going forward. In June, the federal government reduced the maximum amortization period from 30 years to 25 years on new CMHC insured mortgages. Also, CMHC will no longer insure mortgages over $1 million. Finance Canada believes that less than 5% of Canadian home buyers will be affected by the new rules.

In its second quarter update, CMHC expects Alberta's housing market to show marked improvement in 2012. Led by growth in multiple-family units, housing starts are expected to grow a strong 19.4% to 30,700. However, the agency expects the average resale price to remain relatively flat, rising by only 2% to $360,900.

Alberta's housing market is not immune to risks

Alberta's housing market is subject to many of the same risks as the broader economy. The main risk is a further deceleration in global economic growth, caused by an escalation of the European debt crisis and a further slowdown in emerging economies. These events could weigh on oil and other commodity prices and have negative effects on investment, jobs and income growth.

Another risk to housing demand is the threat of higher interest rates. Elevated global uncertainty has dampened odds that the Bank of Canada will raise rates this year. However, over the medium term, an inevitable increase in interest rates will place a strain on highly indebted households and may weigh on housing demand.

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